

China vows "zero tolerance" towards financial fraud in the capital markets

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The Central People's Government has called for "zero tolerance" towards financial fraud in the Mainland capital markets and has pledged to clamp down on major capital market violations, following a recent meeting held by the Financial Stability and Development Committee (FSDC) under the State Council presided over by Vice-Premier Liu He.

In its statement issued on 12 July 2020, the FSDC acknowledged that shortcomings in the design of the current financial system and the low cost of committing financial crime has led to several recent accounting scandals, including Kangmei Pharmaceutical and Kangde Xin Composite Material Group both listed on the Chinese stock market.

With a view to maintaining a stable capital market environment, the FSDC announced seven measures aimed at enhancing the enforcement of laws and regulations in the Mainland securities sector:

1. To speed up the investigation of cases and to impose stricter penalties more promptly;
2. To strengthen the civil compensation and criminal accountability regimes, as well as speed up the preparation and implementation guidelines and regulations regarding the recently revised PRC Securities Law, and to promptly launch class-action lawsuits in relation to cases of major significance and cases having a severe social impact;
3. To continue reform of the delisting system, further improve delisting standards, simplify delisting procedures, strengthen supervision over the delisting process, and strictly implement the delisting system, so as to form a market-oriented delisting system that excludes unfit companies from the market;
4. To cooperate with the legislature to amend the PRC Criminal Law with a view to further improving the legal system for preventing illegal conduct;
5. To enhance the enforcement of the PRC Securities Law which incorporates Chinese characteristics and meets the needs of developing the capital markets, strengthen the basic system of administrative law enforcement, unify law enforcement standards, standardise law enforcement actions, improve law enforcement efficiency, and strengthen specialised law enforcement forces;
6. To establish a dedicated team to coordinate the efforts of the China Securities Regulatory Commission (CSRC) and the other relevant authorities to prevent illegal activities in the capital markets and maintain a stable capital market environment;
7. To educate the public by increasing the publicity around law enforcement work relating to key cases and send a clear signal of "zero tolerance" to the market.

It is anticipated that Mainland regulators will continue to intensify their efforts to combat financial fraud in the capital markets and protect the rights and interests of investors. According to a report issued by the CSRC on 17 April 2020, in 2019 a total of 4.18 billion yuan (about US\$591.5 million) in confiscations and fines was collected by the CSRC for illegal practices in the securities sector, 296 administrative penalties were handed out and 66 individuals were prohibited from re-entering the securities market by the CSRC.

The measures announced by the FSDC are consistent with those adopted by regulators around the world in seeking

to strengthen regulation of the capital markets to promote market integrity and protect investors, particularly given the greater volatility and operational risks caused by COVID-19. The measures aimed at reform of the delisting system are similar to the more robust delisting policy adopted by the Hong Kong Stock Exchange in 2018 to remove unfit companies from the Hong Kong market.

The FSDC's actions follow the issue of new guidelines by the China Banking and Insurance Regulatory Commission to clamp down on financial crimes in the banking and insurance sectors. In light of the Chinese regulators' determination of crackdown on illegal activities in the capital markets, intermediaries and listed companies should be more vigilant about preventing financial fraud and ensure that corporate governance and accounting standards are legally compliant.

Your Key Contacts



Richard Keady

Partner, Hong Kong

D +852 2533 3663

richard.keady@dentons.com



Qianwu Yang

Senior Partner, Shenzhen

D +86 0755 2622 4880

M +86 139 2521 2009

qianwu.yang@dentons.cn



Grace Lee

Associate, Hong Kong

D +852 2533 3650

grace.rc.lee@dentons.com